Billing Code 4210-67

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Chapter II

[Docket No. FR-5572-N-01]

Federal Housing Administration (FHA) Risk Management Initiatives: Revised Seller Concessions

AGENCY: Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

ACTION: Request for comments.

SUMMARY: On July 15, 2010 (75 FR 41217), HUD issued a notice seeking comment on three initiatives that HUD proposed would contribute to the restoration of the Mutual Mortgage Insurance Fund (MMIF) capital reserve account. On September 3, 2010 (75 FR 54020) , HUD published a follow-up final rule implementing the proposal to introduce a minimum credit score and reduce the maximum loan-to-value ratio for FHA single family mortgage insurance. HUD is in the process of implementing another notice tightening the underwriting standards for mortgage loan transactions that are manually underwritten. This document addresses the third proposal; namely, the proposal to reduce the amount of closing costs a seller may pay on behalf of a homebuyer purchasing a home with financing insured by the Federal Housing Administration (FHA). This document takes into consideration the public comments on the July 15, 2010, final rule regarding the proposed cap on "seller concessions" and revises the proposed cap in response. HUD is seeking comment for 30 days on this revised proposal for limiting seller concessions.

DATES: Comment Due Date **[Insert date that is 30 days after date of publication in the Federal Register.]**

FOR FURTHER INFORMATION CONTACT: Karin Hill, Director, Office of Single Family Program Development, Office of Housing, Department of Housing and Urban Development, 451 7th Street, SW, Room 9278, Washington, DC 20410; telephone number 202-708-4308 (this is not a toll-free number). Persons with hearing or speech impairments may access this number through TTY by calling the toll-free Federal Relay Service at 800-877-8339.

SUPPLEMENTARY INFORMATION

I. Background

A. HUD's July 15, 2010 Notice

On July 15, 2010, at 75 FR 41217, HUD issued a notice seeking comment on three initiatives that HUD proposed would contribute to the restoration of the Mutual Mortgage Insurance Fund (MMIF) capital reserve account. The proposed changes were developed to preserve both the historical role of the Federal Housing Administration (FHA) in providing a home financing vehicle during periods of economic volatility and HUD's social mission of helping underserved borrowers. In the July 15, 2010, notice, HUD proposed the following: (1) to reduce the amount of closing costs a seller (or other interested third parties) may pay on behalf of a homebuyer purchasing a home with FHA-insured mortgage financing for the purposes of calculating the maximum mortgage amount; (2) to introduce a credit score threshold, as well as reduce the maximum loan-to-value (LTV) for borrowers with lower credit scores who represent a higher risk of default and mortgage insurance claim; and (3) to tighten underwriting standards for mortgage loan transactions that are manually underwritten.

Over the past 3 years, the volume of FHA insurance has increased rapidly as private sources of mortgage finance retreated from the market. FHA's share of the single-family mortgage market was estimated at 17 percent (33 percent for home purchase mortgages) in Fiscal

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Year (FY) 2010, up from 3.4 percent in FY 2007, and the dollar volume of insurance written has jumped from the $77 billion issued in FY 2007 to $319 billion in FY 2010. The growth in the MMIF portfolio over such a short period of time coincided with worsening economic conditions that have seen high levels of defaults and foreclosures and, consequently, unacceptable risks of loss to the MMIF.[1] The National Housing Act (12 U.S.C. 1701 et seq.), which authorizes FHA's mortgage insurance, envisions that FHA will adjust program standards and practices, as necessary, to operate the MMIF on a financially sound basis.

The independent actuarial study conducted in 2009 showed that the MMIF capital ratio has fallen below its statutorily mandated threshold.[2] Consistent with HUD's responsibility under the National Housing Act to ensure that the MMIF remains financially sound, HUD published the July 15, 2010, notice and sought public comment on the three proposals described above. The July 15, 2010, notice represented another step in HUD's effort to preserve the MMIF and preserve FHA as a source of available credit for affordable home mortgages. Interested parties are referred to the July 15, 2010, notice for details regarding the proposed changes to FHA requirements.

B. The September 3, 2010 Final Rule implementing new credit score and loan-to-value requirements

[1] While the Federal Credit Reform Act of 1990 requires that FHA (and all other government credit agencies) estimate and budget for the anticipated cost of mortgage loan guarantees, the National Housing Act imposes a special requirement that the MMIF hold an additional amount of funds in reserve to cover unexpected losses. FHA maintains these back-up funds in the MMIF capital reserve account, a special reserve account.

[2] On November 13, 2009, HUD released an independent actuarial study that reported that FHA will likely sustain significant losses from mortgage loans made prior to 2009, due to the high concentration of seller-financed downpayment assistance mortgage loans and declining real estate values nationwide, and that the MMIF capital reserve relative to the amount of outstanding insurance in force had fallen below the statutorily mandated 2 percent ratio. The capital ratio generally reflects the reserves available (net of expected claims and expenses), as a percentage of the current portfolio, to address unexpected losses. The report can be found at: http://www.hud.gov/offices/hsg/fhafy09annualmanagementreport.pdf.

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At the close of the public comment period on August 16, 2010, HUD had received 902 public comments in response to the July 15, 2010, notice. The majority of the public comments focused on the reduction in seller concessions. In order to provide the necessary additional time to consider the issues raised by the commenters, HUD decided to separately implement the three proposals contained in the July 15, 2010, notice.

On September 3, 2010, at 75 FR 54020, HUD published a final rule implementing the introduction of a minimum credit score and the reduction in the maximum LTV ratio for FHA single family mortgage insurance. The September 3, 2010, final rule also contained a discussion of the public comments received in response to the new credit score and LTV requirements. The final rule advised that HUD's decision on the two other proposals described in the July 15, 2010, notice would be addressed separately.

Commencing on October 4, 2010, borrowers were required to have a minimum decision credit score of no less than 500 to be eligible for FHA financing. The LTV for FHA-insured mortgage loans (purchase and refinance) is limited to 90 percent for borrowers with a decision score between 500 and 579. Maximum FHA-insured financing (96.5 percent LTV for purchase transactions and 97.75 percent for rate-and-term refinance transactions) continues to be available for borrowers with credit scores at or above 580. However, FHA is providing a special, temporary allowance to permit higher LTV mortgage loans for borrowers with lower decision credit scores, so long as they involve a reduction of existing mortgage indebtedness pursuant to FHA program adjustments announced in HUD Mortgagee Letter 2010-23. Interested readers are referred to the September 3, 2010, final rule and HUD Mortgagee Letter 2010-29 for additional information regarding the new credit score and LTV requirements. All HUD Mortgagee Letters are available at: http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/.

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C. Proposed final rule implementing revised manual underwriting requirement

HUD is in the process of finalizing a rule implementing the revised manual underwriting requirements and addressing the public comments received on this proposal in response to the July 15, 2010, notice. The new manual underwriting requirements will reduce the risk to the MMIF and ensure that homebuyers are offered mortgage loans that are sustainable.

As discussed in the July 15, 2010, notice, the purpose of mortgage underwriting is to determine a borrower's ability and willingness to repay the debt and to limit the probability of default. An underwriter must consider a borrower's credit history, evaluate the borrower's capacity to repay the loan based on income and current debt, determine if cash to be used for closing is sufficient and from an acceptable source, and determine if the value of the collateral supports the amount of money being borrowed. In cases where the borrower has a very limited or nontraditional credit history, a credit score may not have been issued by the credit bureaus, or the credit score may be based on references that are few in number or do not effectively predict future credit worthiness. Mortgage loans for borrowers in this category are manually underwritten as are all "Refer" risk classifications provided by FHA's TOTAL Mortgage Score Card. These categories of borrowers require a more extensive review that can be tailored to circumstances to discern the level of risk. Manual underwriting guidelines are generally more stringent to address that higher risk level. The final rule will consider factors for manually underwritten mortgage loans.

II. This Notice — Reduction of Seller Concession: Revised Proposal for Reducing Seller Concessions

This notice revises the third proposal contained in the July 15, 2010, notice; namely, the proposed cap on the amount of "seller concessions" that can be considered as offsets to actual

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closing costs rather than inducements to purchase. When a homeseller pays all or part of the buyer's closing costs and other fees, such payments are referred to as seller concessions. Seller concessions include any payment toward the borrower's closing costs and other fees, by any third party with an interest in the transaction, including the seller, builder, developer, mortgage broker, lender, or Settlement Company. HUD's existing policy defining seller concessions provides that any concessions exceeding 6 percent must be treated as inducements to purchase, resulting in a reduction in the FHA mortgage amount.

A. Changes to the July 15, 2010, Notice.

In the July 15, 2010, notice, HUD proposed to cap the seller concessions in FHA-insured, single-family mortgage transactions at 3 percent of the lesser of the sales price or appraised value, for the purpose of calculating the maximum insured mortgage amount, reducing it from the 6 percent limitation currently in place. As discussed in the July 15, 2010, notice, conventional mortgage lenders have capped allowances for seller concessions at 3 percent of the sales price on loans with LTV ratios similar to FHA. Loans guaranteed by the Department of Veterans Affairs have a cap on seller concessions of 4 percent of the sales price. In the July 15, 2010, notice, HUD also provided statistical data illustrating a higher incidence of home loss for borrowers who received seller concessions in excess of 3 percent. The proposed cap was designed to align FHA's single-family mortgage insurance programs to industry practice and reduce home loss among homebuyers relying on FHA-insured financing. Of the homebuyers with FHA-insured mortgages, 82 percent of such homebuyers make only the minimum required downpayment of 3.5 percent. It is important, therefore, for HUD to assure that allowable mortgage amounts are appropriately adjusted for what may actually be inducements to purchase.

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For borrowers having more than the minimum required downpayment of 3.5 percent, this rule may or may not affect them.

As noted in the preamble, the majority of the 902 public comments received in response to the July 15, 2010, notice pertained to the proposed cap on seller concessions. Comments were submitted by mortgage lenders, credit unions, realtors, home builders, state housing finance agencies, and other interested organizations. After careful consideration of the issues raised by the commenters, HUD has decided to make the following changes to the proposed cap to seller concessions and seek public comment on those changes:

- Reduce the amount of seller concessions permitted as offsets to actual closing costs to 3 percent[3] or $6,000, whichever is greater, but not allow the offsets, in any event, to exceed the borrower's actual costs. This reduction in concession allowances does not apply to HUD's Real Estate Owned homes and Neighborhood Stabilization programs, for which the allowance remains at 6 percent.
- Limit acceptable uses of seller concessions to payments toward borrower closing costs, prepaid items, discount points, the FHA Up Front Mortgage Insurance Premium, and any Interest Rate Buydown. This revised definition eliminates payment supplements such as homeowner or condominium association fees, mortgage interest payments, and mortgage payment protection plans.

To address potential future increases in closing costs, the $6,000 cap established in this notice is not static but tied to an index. The dollar limitation may increase annually, and at the same percentage rate as the FHA national loan limit floor, rounded up to the nearest $100 for

[3] The percentage is based on the lesser of sales price or appraised value.

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anything at or above $50 increments and rounded down to the nearest $100 for anything below $50 increments. For example, should the FHA national loan limit floor rise by 1.5 percent, then the cap may increase to $6,100. Any increase in the dollar limitation will be announced via mortgagee letter, most likely in the same mortgagee letter that announces the new FHA loan limits for the upcoming calendar year.

This revised proposal takes into consideration the disproportionately negative impact an across-the-board reduction to 3 percent would have had on borrowers with low and moderate incomes who are purchasing modestly priced homes. It also appropriately limits the dollar amount of seller concessions on higher-priced homes, which under currently policy could be as high as $43,785.[4] Concession amounts above the revised-proposal limit would not be prohibited, but rather would result in a dollar-for-dollar reduction in the sales price for the purpose of calculating the maximum insured loan amount.

B. Definition of Acceptable Concessions

As part of the revised proposal on reducing seller concessions, HUD is also proposing to narrow the definition of acceptable concessions. In this new definition, HUD continues to permit sellers to pay for the borrower’s actual costs to close on the loan, as well as pay the Up Front Mortgage Insurance Premium due on the loan and fund an Interest Rate Buydown.[5] What HUD proposes to eliminate are payment supplements offered by sellers, such as a year’s worth of homeowner association fees, 6 months’ worth of mortgage interest, or mortgage payment

[4] That amount is 6 percent of FHA’s current national mortgage limit ceiling of $729,750.

[5] Interest Rate Buydowns are designed to reduce the borrower's monthly payment during the early years of the mortgage. At settlement, an escrow account is established and each month, the servicing lender draws down an amount equal to the difference between the principal and interest payment (P&I) at the Note rate, and the P&I at the buydown rate. For more information on FHA requirements for Interest Rate Buydowns, see HUD Handbook 4155.1 6.A.2.

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protection plans. HUD believes that these types of payment supplements, while permissible under current seller concession guidance, are really inducements to purchase and should be treated as such. The impact of this revised definition should be minimal on the housing market since the loan level review of FHA-insured loans revealed that sellers typically offer concessions that pay for borrowers' actual costs to acquire the property, and not payment supplements.

Current Seller Concession Definition	**Proposed Seller Concession Definition**
The seller and/or interested third party may contribute towards the buyer's: • Closing Costs • Prepaid Expenses • Discount Points • Interest Rate Buydowns and other payment supplements (i.e. Homeowner Association fees) • Payments of mortgage interest for fixed-rate mortgages • Mortgage Payment Protection Insurance and Up-Front Mortgage Insurance Premium All other third-party contributions are considered inducements to purchase, resulting in a dollar-for-dollar reduction to the lesser of sale price or appraised value before applying the appropriate LTV factor (96.5%). This excludes closing costs and prepaid items paid by the lender through premium (rebate) pricing.	The seller and /or interested third party may contribute towards the buyer's: • Closing Costs • Prepaid Expenses • Discount Points • UFMIP • Interest Rate Buydowns All other third-party contributions are considered inducements to purchase, resulting in a dollar-for-dollar reduction to the lesser of sale price or appraised value before applying the appropriate LTV factor (96.5%). This excludes closing costs and prepaid items paid by the lender through premium (rebate) pricing.

Closing costs vary from borrower to borrower, lender to lender, and state to state. These costs even vary from closing cost study to closing cost study, because each study defines closing costs in slightly different ways. The definition of closing costs for HUD's analysis included fixed and variable closing costs, but not prepaid expenses, because prepaid expenses are typically financed. Fixed costs are those that are a fixed dollar amount, are not tied to a percentage of the loan amount, and are generally offered within a dollar range. Variable costs are those that are based on a percentage of the loan amount, or property value. Prepaid items include funds needed to establish an escrow account, as well as state and local property taxes and

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per diem interest. FHA's Upfront Mortgage Insurance Premium is also included in this category, and it is typically prepaid by financing into the mortgage amount.

Categories of Closing Costs		
Fixed	Variable	Prepaid
Appraisal	Adjusted Origination Charge	Hazard/Homeowners Insurance
Credit Report	Lenders Title Insurance	Flood Insurance
Survey	Lender's Title Insurance	Homeowners/Condominium Association Fees
Pest Inspection	Owner's Title Insurance	Upfront Mortgage Insurance Premium
Title Services	Transfer Tax	Taxes
Lien Certification		Per Diem Interest
Flood Certification		
Flood Determination		
Lender Inspection		

In the July 15, 2010, notice, HUD clarified the definition of Interested Third Party. HUD is not revising the definition of Interested Third Party but clarifying the definition where it was vague and possibly subject to varied interpretation.

Current Interested Third Party Definition	**Clarification of Interested Third Party Definition**
Seller or other interested parties such as real estate agents, builders, developers, etc., or combination of these parties.	Seller or other interested party such as a real estate agent, builder, developer, mortgage broker, lender, and/or settlement company.

C. Statutory Authority

FHA has determined that maintaining the amount of eligible seller concessions at 6 percent of the sales price of the property increases the risk of default and claim payment by FHA from the insurance fund. FHA's determination is solidly based on statutory grounds in both the National Housing Act and the Department of Housing and Urban Development Act (42 U.S.C. 3531 et seq.) There are five specific statutory areas that support the action by FHA to reduce the amount of allowable seller concessions for FHA purposes: (1) the mortgagor's ability to pay the

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mortgage; (2) the amount of funds the mortgagor must have available to close; (3) the Secretary's fiduciary duty to the MMIF; (4) the capital ratio of the MMIF; and (5) FHA risk management. Each one of these five statutory grounds is explained in more detail below.

1. Ability to pay mortgage payment. Section 203(b)(4) of the National Housing Act provides that the mortgage, in order to be eligible for insurance, must contain complete amortization provisions satisfactory to the Secretary requiring periodic payments by the mortgagor not in excess of his reasonable ability to pay as determined by the Secretary. FHA has found that seller concessions can, in some instances, affect the borrower's ability to make monthly mortgage payments some time after the mortgage loan is closed. An example is when certain reoccurring homeownership costs are prepaid on a temporary basis, but then, after the prepayment period ends, become the financial burden of the mortgagor. FHA has found that the seller concessions such as prepayment of taxes or homeowner association fees, which then become due a year or two later, can result in mortgagors experiencing mortgage payment shock and subsequent default. This example of an impact on a mortgagor's reasonable ability to pay illustrates a clear statutory basis under section 203(b)(4) of the National Housing Act for issuing this notice.

2. Money to close. Section 203(b)(9)(A) of the National Housing Act, as amended by the Housing and Economic Reform Act of 2008 (Public Law 110-289, approved July 30, 2008), addresses the need for a mortgagor to make a minimum investment in the purchase of the mortgaged property. Under section 203(b)(9)(A) of the National Housing Act, the mortgagor shall have paid on account of the property an amount equal to not less than 3.5 percent of the appraised value of the property or such larger amount as the Secretary may determine. The reduction in seller concessions impacts on the funding that the homebuyer has to bring to the

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table to close. Indirectly, by reducing the amount of seller concessions, the Secretary is determining that the mortgagor must pay on account of the property an amount that can be greater than the minimum 3.5 percent. Requiring, directly or indirectly, that the mortgagor must come to the closing table with more of his own funds is clearly rooted in this statutory provision of the National Housing Act.

3. Fiduciary Duty to the MMIF. The determination to decrease the allowable amount of seller concessions is part of FHA's ongoing risk management practices. FHA is a large government insurance corporation, and has statutorily mandated requirements placed upon it to manage its financial affairs prudently. One of the statutes with such a mandate is found at section 202(a)(3) of the National Housing Act. Under that section, the Secretary has a fiduciary duty to ensure that the MMIF remains financially sound. Taking action such as issuing this Notice regarding seller concessions furthers the Secretary's obligation to meet the requirements of this section of the National Housing Act. Reducing defaults and subsequent claims for insurance benefits payments from the MMIF logically should financially help the MMIF.

4. Capital Ratio of the MMIF. Coupled with the fiduciary duty to preserve the MMIF is the statutory requirement to maintain an adequate MMIF capital ratio. Under section 205(f)(2) of the National Housing Act, the Secretary shall ensure that the capital ratio of the MMIF is maintained at not less than 2 percent. The ratio has fallen below this threshold, and this is one action of many that FHA is taking to address this statutory requirement.

5. FHA Risk Management. Under section 4(b) of the Department of Housing and Urban Development Act, the Secretary shall ensure that managers of the FHA are held accountable for program operations and risk management along with other duties. Because the action proposed by this Notice addresses risk management directly, reducing the amount of eligible seller

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concessions is authorized under this statutory provision. As is more fully addressed in Section III of this Notice, which discusses the public comments received on the July 15, 2010, notice, some program participants have expressed concerns that reducing the amount of seller concessions may impact the housing market at a time when the market is depressed. However, FHA also has obligations to manage the MMIF soundly and prudently. The reduction in the amount of seller concessions is specifically being implemented to directly meet these statutory mandates, and is being done in accordance with specific statutory authority governing required funds to close and the mortgagor's ability to make the monthly mortgage payments. FHA officials would be remiss in their fiscal responsibilities if this action, after thoughtful study and analysis of program data and careful review of and taking into account the public comments, was not implemented.

D. Reducing Seller Concessions

Many of the commenters on the July 15, 2010, notice suggested that the primary illustration of credit risk for loans with high rates of seller concessions was not appropriate because it focused on loans insured from 2005 to 2008, and those insurance endorsements had large shares with seller-funded downpayment assistance and with lower borrower credit scores than are acceptable to HUD today. In response, HUD has completed an analysis of 2009 and 2010 loans. These latter loans were originated after the use of seller-funded downpayments was made illegal, and after lenders tightened their own internal credit guidelines to eliminate the low credit score loans that made up a sizable portion of FHA insurance activity in the 2005-to-2008 period. Loans outside of current HUD policy on minimum borrower credit scores also were

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excluded from the analysis, though they comprised only a small number of the 2009 and 2010 loan originations.[6]

In this new analysis, HUD addresses four key areas: (1) the distribution of closing costs and concessions in dollar amounts and in percent of property value, for different sized loans; (2) the introduction into the FHA portfolio of loans for much larger amounts than had been insured in previous years; (3) the juxtaposition of closing costs and concessions, by percent of property value; and (4) the credit risk associated with different levels of seller concessions.

To prepare this revised proposal, HUD updated its data analysis to use more recent loan originations. While this does not provide the type of loan seasoning that demonstrates long-run performance and credit risk, as was shown in Table C of the July 15, 2010, notice, it does permit differentiation between low- and high-balanced loans to a degree not possible with earlier loan originations. Prior to passage of the Economic Stimulus Act of 2008, the FHA national loan limit ceiling was $369,720; after that, it rose to $729,750, where it remains today, which causes HUD to be concerned about credit risk from high dollar concession amounts on high balanced loans with high loan-to-value ratios.

For this analysis, HUD developed a data set of borrower-required closing costs and seller concessions that covers 74 percent of the two million FHA insured home purchase loans originated in 2009 and 2010.[7] To measure credit risk on these loans, HUD focused only on 2009 loan originations, which now have as much as 26 months of seasoning. Patterns of credit risk already seen in this population are likely to persist over the life of the loans.

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[6] These are loans for which borrower credit scores are below 500, or for which the credit scores are below 580 if the loan-to-value ratio is above 90 percent.

[7] Loans were excluded from this analysis primarily because HUD was not able to discern from the various data submitted by lenders the amounts of total borrower required closing costs and/or the presence of seller concessions. A small number of loans were excluded because borrower credit scores were below current limits for FHA eligibility.

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Table A shows the distribution of borrower-required closing costs as a percentage of home value. That information highlights how fixed-cost factors tend to create percentage amounts that are greatest for small balance loans. More than 70 percent of loans of up to $180,000 have closing costs in excess of 3 percent of property value, while among loans above $240,000, the share is just 26 percent.

Table A. Borrower Closing Costs - by Loan Amount and Percent of Property Value
2009-2010 FHA-Insured Loan Originations

Loan Amt. ($ 000)	Percent of Property Value (rows sum to 100%)[a]						
	<=1	2	3	4	5	6	>6
<=180	1.35%	8.42%	19.12%	25.51%	19.37%	11.36%	14.88%
181-240	4.50	20.23	35.59	22.50	9.55	4.25	3.39
241-360	8.63	29.80	35.40	15.35	6.26	2.88	1.68
> 360	11.81	33.51	29.13	14.02	6.95	3.14	1.44
All	4.45%	18.57%	30.22%	22.03%	11.97%	6.18%	6.57%

[a] Property value is measured as the lesser of the purchase price and the appraisal amount. Each category here, except for the final one, represents amounts up to the percentage shown in the column heading.

Concessions are present in 65 percent of FHA-insured home purchase loans. That rate appears to have been fairly constant over time; data samples taken by HUD on FY 2000 to 2002 home purchase loans insured by FHA show a similar rate of concessions. Table B provides a companion to Table A, highlighting the distribution of seller concessions, by size, in percent of home value. The greatest rate of use of concessions is for loan amounts up to $240,000, and the greatest share of concessions for amounts above 3 percent of property value are for the lowest loan amount categories shown there, and especially for loan amounts up to $180,000.

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Table B. Seller Contributions as a Percent of Property Value 2009-2010 FHA-Insured Loan Originations								
Loan Amt. ($ 000)	Percent of Property Value[a] (rows sum to 100%)							
	0[a]	1	2	3	4	5	6	>6[b]
<= 180	34.02%	2.55%	8.29%	21.25%	16.43%	8.95%	8.03%	0.48%
181-240	32.74	6.04	16.43	27.59	11.98	3.47	1.65	0.09
241-360	38.79	9.52	21.51	21.38	6.18	1.58	0.99	0.05
> 360	47.28	12.54	18.96	13.93	3.73	1.91	1.61	0.04
All	34.66%	5.76%	14.76%	24.15%	12.15%	4.81%	3.50%	0.20%

[a] Property value is measured as the lesser of the purchase price and the appraisal amount. Each category here, except for the final one, represents amounts up to the percentage shown in the column heading.
[b] Shares of loans with rates of closing costs and concessions above 6 percent rose in 2010 in conjunction with a higher share of loans on properties with purchase prices below $50,000.

Table C juxtaposes information from Tables A and B to show how concession rates align with closing-cost rates. Shaded cells represent loans for which concessions are generally larger than the closing costs. Those account for 7 percent of all loans and 10 percent of loans with concessions. Table C also shows that the largest single concentration of loans (13.77 percent) is found where both closing costs and concessions are between 2 and 3 percent of home value. As seen in Table A, closing costs occur in this range for more than 30 percent of all home-purchase loans insured by FHA. Table B shows that concessions in this range represent 24 percent of all subject loans, and 37 percent of loans with concessions. The next largest concentrations seen in Table C (for loans with positive concessions) are for loans where closing costs and concessions are both between 1 and 2 percent of property value (7.62 percent), and those where each measure is between 3 and 4 percent of property value (7.21 percent). The next highest concentrations also are adjacent to the most populated group.

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Table C. Borrower Closing Costs and Concessions, in Percentage of Property Value[a] 2009 - 2010 FHA-Insured Loan Originations									
Closing Cost Rate (% of Value)	Concessions Rates (% of Value)								All
	0[b]	<=1	2	3	4	5	6	>6	
1	2.21%	1.10%	0.33%	0.50%	0.21%	0.06%	0.04%	0.00%	4.45%
2	7.03%	1.57%	7.62%	1.52%	0.57%	0.15%	0.10%	0.01%	18.57%
3	8.99%	1.66%	4.00%	13.77%	1.23%	0.35%	0.20%	0.01%	30.22%
4	6.74%	0.81%	1.66%	4.72%	7.21%	0.49%	0.37%	0.02%	22.03%
5	4.06%	0.35%	0.65%	1.98%	1.67%	2.84%	0.41%	0.02%	11.97%
6	2.38%	0.15%	0.27%	0.88%	0.72%	0.53%	1.23%	0.02%	6.18%
9	3.25%	0.12%	0.23%	0.77%	0.54%	0.39%	1.15%	0.13%	6.57%
All	34.66%	5.76%	14.76%	24.15%	12.15%	4.81%	3.50%	0.20%	100.00%

[a]Property value is the lesser of purchase price and appraisal amount.
[b]Any amount up to $500 is considered zero.

Table D provides summary statistics on the dollar amounts of closing costs and concessions, by the same four loan-amount classes shown in Tables A and B.

Table D. Borrower Closing Costs and Seller Concessions Descriptive Statistics by Loan Amount							
Loan Amt. ($ 000)	Cost or Concession	Loans	Percentiles				
			5th	25th	50th	75th	95th
Dollar Amounts							
<=180	Cost	449,548	1,489	2,561	3,435	4,476	6,904
	Concession	449,548	0	0	2,049	3,251	4,900
181-240	Cost	748,048	1,789	3,385	4,571	6,054	9,594
	Concession	748,048	0	0	3,000	4,703	7,012
241-360	Cost	203,623	2,335	4,759	6,586	8,933	14,610
	Concession	203,623	0	0	3,150	6,468	10,062
> 360	Cost	69,346	3,209	6,794	9,795	14,253	23,702
	Concession	69,346	0	0	1,527	8,155	16,453
Percentage of Home Value							
<=180	Cost	449,548	1.60	2.84	3.82	5.09	8.01
	Concession	449,548	0.00	0.00	2.44	3.50	5.71
181-240	Cost	748,048	1.04	2.01	2.71	3.56	5.53
	Concession	748,048	0.00	0.00	1.75	2.87	4.04

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241-360	Cost	203,623	0.81	1.66	2.27	3.05	4.90
	Concession	203,623	0.00	0.00	1.11	2.23	3.49
> 360	Cost	69,346	0.70	1.51	2.12	3.03	4.92
	Concession	69,346	0.00	0.00	0.33	1.83	3.54

Tables E – G parallel Tables A – C and provide performance information for loans originated in 2009.[8] The defining metric is a "failure" rate, which includes all loans that have either resulted in an insurance claim (as of March 31, 2011), are presently in foreclosure processing, or else have gone through the foreclosure process but the insurance claim has not yet been filed or processed. HUD adopted this metric because present economic circumstances are resulting in delays both in foreclosure completions and in claim filings. In addition, focusing on such "failures" is more directly associated with losses to the FHA insurance operations than are delinquency rate measures.[9]

These tables show that, within each loan amount category, credit risk is highest for loans with larger closing costs and with larger concessions. For loan amounts above $240,000, credit risk rises faster and higher than it does for lower loan amounts, as closing cost and concessions each exceed 3 percent of property value. Table F shows that while the lowest risk loans are those in the highest loan amount category (above $360,000), when no concessions are present, the highest risk is for the same category of loans when concessions are above 4 percent of property value, and especially when they are above 5 percent. In Table E, the highest loan-amount group also shows the highest credit risk of all is when closing costs exceed 4 percent.

[8] Loans originated in 2010 are still too new for there to be defined performance patterns. The 2009 loans comprise 51.6 percent of the cases in this analysis.
[9] HUD recognizes that not all loans for which a foreclosure process is started will result in loss of a home to the borrower and claim payment from FHA. However, the various rates at which foreclosure actions have been initiated do provide a valid measure for differentiating credit risk across groups of loans.

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Table E. To-Date Failure Rates[a] by Loan Amount and Borrower Closing Cost Rates
2009 Loan Originations

Loan Amt ($ 000)	Borrower Closing Cost (Percent of Property Value[b])							All
	<= 1	2	3	4	5	6	> 6	
<=180	0.92%	0.81%	0.99%	1.11%	1.11%	1.19%	0.99%	1.04%
181-240	0.65	0.70	0.79	0.91	0.74	1.04	0.98	0.79
241-360	0.61	0.79	0.92	1.03	1.12	1.24	1.48	0.88
> 360	0.63	0.62	0.86	1.22	1.70	3.73	2.32	0.93
All	0.66%	0.73%	0.85%	1.00%	0.98%	1.20%	1.02%	0.89%

[a] Failure is defined as a loan having either resulted in an insurance claim, or in foreclosure processing today, or else a foreclosure action has been completed and a claim filing is pending. Data as of March 31, 2011.
[b] Property value is measured as the lesser of the purchase price and the appraisal amount. Each category here, except for the final one, represents amounts up to the percentage shown in the column heading.

Table F. To-Date Failure Rates[a] by Loan Amount and Seller Concessions Rates
2009 Loan Originations

Loan Amt. ($ 000)	Seller Concessions (Percent of Property Value[b])								All
	0[b]	<=1	2	3	4	5	6	>6	
<=180	0.72%	1.12%	1.01%	1.03%	1.18%	1.41%	1.58%	2.15%	1.04%
181-240	0.62	0.67	0.73	0.87	1.04	1.09	1.45	1.71	0.79
241-360	0.70	0.79	0.82	1.03	1.48	1.85	1.51	2.27	0.88
> 360	0.58	0.91	0.76	1.15	1.53	2.24	6.70	0.00[c]	0.93
All	0.66%	0.77%	0.80%	0.94%	1.14%	1.32%	1.66%	2.02%	0.89%

[a] Failure is defined as a loan having either resulted in an insurance claim, or in foreclosure processing today, or else a foreclosure action has been completed and a claim filing is pending. Data is as of March 31, 2011.
[b] Any amount up to $500 is considered zero; other categories represent amounts greater than the next lower limit, and up to the percentage listed; rows add to 100 percent.
[c] There are just 19 loans in this cell.

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Table G. To-Date Failure Rates[a] by Closing Cost (CC) and Seller Concessions (SC) Rates[b]
2009 Loan Originations

Closing Costs (%)	Seller Concessions (%) 0[c]	<=1	2	3	4	5	6	>6	by CC rate
<=1	0.55%	0.69%	0.57%	0.80%	1.05%	1.36%	1.28%	4.35%	0.66%
2	0.63	0.70	0.80	0.73	0.79	1.32	1.11	0.00	0.73
3	0.65	0.84	0.70	0.99	1.06	1.08	1.40	1.11	0.85
4	0.73	0.85	1.00	0.89	1.25	1.02	1.88	2.68	1.00
5	0.61	1.00	0.90	0.80	0.90	1.44	1.64	2.74	0.98
6	0.80	0.87	1.22	1.07	1.09	1.18	1.86	3.25	1.20
>6	0.73	1.41	1.26	0.85	0.75	1.38	1.48	1.70	1.02
by SC rate	0.66%	0.13%	0.39%	0.73%	0.43%	0.20%	0.19%	0.01%	0.89%

[a] Failure is defined as a loan having either resulted in an insurance claim, or in foreclosure processing today, or else a foreclosure action has been completed and a claim filing is pending. Shaded cells represent loans for which concessions are larger than closing costs. Data is as of March 31, 2011.
[b] Rates are in percent of property value (lesser of purchase price and appraisal amount).
[c] Any amount up to $500 is considered zero; other categories represent amounts greater than the next lower limit, and up to the percentage listed; rows add to 100 percent.

E. <u>Establishing the Seller Concession Percentage Cap and Dollar Limitation</u>

The Department recognizes that an across-the-board reduction in concession allowances could have a large negative impact on the ability of low- and moderate-income households to purchase moderate-priced homes. Thus, HUD is revising its proposed limitation on seller concessions to address comments to that effect that were provided in response to the July 15, 2010, notice. Many comments recommended that HUD combine a percentage cap with a dollar limitation. Such a two-part proposal could directly address the higher credit risk of high-balance loans with large seller concessions, while maintaining a sufficiently high allowance for the reasonable range of closing costs found on moderate-priced homes. Such a two-part approach would:

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(1) Reduce the amount of concessions a seller (or other interested third party) could provide that would be considered in excess of actual closing costs or inducements to sale, and

(2) Minimize the impact that such a reduction might have on affordability and access to homeownership for first-time homebuyers needing the low downpayments permitted by FHA in what is still a fragile housing market.

To determine a reasonable percentage cap and dollar limitation, HUD compared the range of actual closing costs for homebuyers with FHA-insured mortgages, as seen in Table D, with the credit risk characteristics of loans with high concessions found in Tables F and G. The result is a new proposal permitting concessions as offsets to actual closing costs on individual loans up to the greater of 3 percent or $6,000 of the lesser of the sales price or appraised value. In mathematical terms, this limitation can be described as:

Minimum [closing_cost, maximum ($6,000, 0.03*property_value)] where

property_value = min (sale price, appraised value) except for 203k where property_value = appraised_value.

Under this proposal, the limiting factor on the allowable dollar amount of concessions will be:

- Closing costs, when the amount is less than $6,000;
- Closing costs, when they are above $6,000 but less than 3 percent of property value;
- $6,000, when that is more than 3 percent of property value and less than total closing costs; or

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- 3 percent of property value, when that amount is both greater than $6,000 and less than closing costs.

Table H provides some benchmark values for understanding how this proposal would affect homebuyers with minimum downpayments, at different loan amounts. For the homebuyer with a $120,000 mortgage (buying a $126,000 home), concessions would be considered offsets to actual closing costs where closing costs are as high as $6,000, or 4.78 percent of the home value. The loan amount after which the 3 percent of property value is greater than $6,000 is $194,930 (buying a $200,000 home). For all larger loan amounts, a borrower may use concessions as offsets to actual closing costs up to 3 percent of property value. At $360,000, concessions may be used to offset actual closing costs, up to $11,304. For a very high loan amount of $600,000, the 3 percent concessions allowance is $18,000.

Table H. Components of the Proposed Limit on Seller Concessions
Examples at Various Loan Amounts

Loan Amount[a]	$ 120,000	$ 180,000	$ 194,930	$ 240,000	$ 360,000
Property Value[b]	125,596	188,394	200,000	251,192	376,788
$6,000 as a % of Value	4.78%	3.18%	3.00%	2.39%	1.59%
3.0% of Value	$ 3,768	$ 5,652	$ 6000	$ 7,536	$ 11,304

[a] Presumed to include the FHA Upfront Mortgage Insurance Premium of 1 percent.
[b] Based upon borrower making the minimum downpayment of 3.5 percent. (Calculated as loan_amount/(0.965/1.01), to also account for the typical financing of the 1 percent upfront insurance premium.)

Referring again to Table D, the $6,000 limitation is generous to borrowers with loan amounts up to $180,000. In that range, $6,000 is beyond the 90th percentile of all borrower closing costs. Thus, less than 10 percent of borrowers with loan amounts under $180,000 would have concession allowances that are less than their actual closing costs. For borrowers in the next loan amount category ($180,000-240,000), $6,000 nearly reaches the 75th percentile of closing costs. However, $6,000 is not the binding limit for borrowers with loan amounts of

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$195,000 or greater (see Table H). In that range, 3 percent of the property value is greater than $6,000 and becomes the amount that is compared with actual closing costs to determine maximum allowable concessions.

Table I illustrates the impact of this revised proposal to the existing concessions limitation and at different sales prices under the proposed reduction. Concessions are more generous than the existing 6 percent limitation for sales prices below $100,000. For sales prices between $100,000 and $200,000, the dollar cap allows for seller concessions greater than 3 percent. Any sales price above $200,000 is limited to the 3 percent cap.

Table I. Comparison of Limitations on Seller Concessions

Sales Price	Existing Seller Concessions Limitation	Proposed Reduction of Seller Concessions is the greater of		Proposed Percentage Cap
	6 percent	3.0 percent	$6,000	%
$100,000	$6,000	$3,000	**$6,000**	**6.0**
$120,000	$7,200	$3,600	**$6,000**	**5.0**
$140,000	$8,400	$4,200	**$6,000**	**4.3**
$160,000	$9,600	$4,800	**$6,000**	**3.75**
$180,000	$10,800	$5,400	**$6,000**	**3.3**
$200,000	$12,000	$6,000	$6,000	3.0
$220,000	$13,200	**$6,600**	$6,000	3.0
$240,000	$14,400	**$7,200**	$6,000	3.0
$260,000	$15,600	**$7,800**	$6,000	3.0
$280,000	$16,800	**$8,400**	$6,000	3.0
$300,000	$18,000	**$9,000**	$6,000	3.0

The actual effects of the proposed limitation, when applied to the 2009 and 2010 loan originations used in this analysis, are shown in Tables J and K. Overall, the limitation would have affected just 13.4 percent of those home purchase loans. The dollar size of the resulting excess contributions is shown in Table J. For the lowest loan amount group, the median effect is

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under $1,000; for the highest loan amount group, it is above $4,000. However, as seen in Table K, among the 9.7 percent of borrowers with loan amounts up to $180,000 that are affected, the binding constraint that creates excess concessions is the actual amount of closing costs in nearly all of those situations (93.4 percent). For the fewer than 7 percent of the affected borrowers in this group, the $6,000 dollar limitation is greater than their closing costs. For loan amounts above $240,000, the share of affected loans constrained by closing costs is more closely balanced with the share that is constrained by 3 percent of property value (56 and 44 percent, respectively).

Table J. Proposed Concessions Limitation, Affects by Loan Size Category
2009-2010 FHA-Insured Loans

Loan Amt. ($ 000)	Number of Loans Affected	Share of Loans Affected	Dollar Reductions – at Various Percentiles (affected loans only)				
			5th	25th	50th	75th	95th
<=180	43,592	9.7%	$ 86	$ 480	$ 988	$ 1,670	$ 3,018
181-240	114,726	15.3%	116	664	1,434	2,562	4,900
241-360	30,499	15.0%	150	1,001	2,247	4,106	8,160
> 360	8,819	12.7%	327	1,850	4,138	7,541	14,635

Table K. Proposed Concessions Limitation
Source of Constraint on Affected Loans,
by Loan Size Category

Loan Amt. ($ 000)	Binding Constraint		
	Closing Cost	Property Value	Dollar Limit
<=180	93.4%	0.11%	6.5 %
181-240	61.9	12.7	25.5
241-360	57.0	43.0	0.04
> 360	54.2	45.7	0.05
All	67.7%	16.0%	16.2 %

Note: Rows sum to 100%

F. Considering Alternative Approaches

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There were a variety of alternative approaches suggested by commenters. Some commenters recommended that HUD defer instituting a cap in favor of monitoring the performance of loans with seller concessions for a period of 2 years. Others suggested adopting the cap used by other federal programs such as the Department of Veterans Affairs Home Loan Program or capping seller concessions based on the buyer's credit score. While these alternatives to the proposed reduction all had merit, HUD believes that they do not sufficiently address the risk to the MMIF and/or they do not adequately mitigate the impact that a reduction in seller concessions may have had on the housing market. In considering all of the alternative approaches, HUD sought to achieve both of these goals. The comments that recommended combining a percentage cap with a dollar limitation met these goals and provided HUD the opportunity to revise this proposal in a manner that would both benefit the housing market and FHA's Mutual Mortgage Insurance Fund.

Section III of this notice discusses all of the significant issues raised by the public comments regarding the July 15, 2010, notice's proposed reduction in the allowable amount of seller concessions, and HUD's responses to these issues.

III. Discussion of the Public Comments Regarding Proposed Reduction in Sellers Concessions

A. Support for Proposed Limit on Seller Concessions.

A minority of the comments expressed support for reducing seller concessions. The commenters wrote that the cap would require a more serious commitment from borrowers and should also help reduce risks to the FHA insurance funds.

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HUD Response. HUD appreciates the support for reducing seller concessions. It believes that this reduction will reduce risk to the MMIF, while at the same time preserving FHA's mission of helping underserved borrowers obtain affordable home financing.

B. Proposed Cap will be Ineffective and Harmful

Comment: HUD failed to provide adequate justification for the proposed reduction, and reducing seller concessions will not result in reduced risk to FHA. Several commenters questioned HUD's stated rationale for limiting seller concessions. The commenters wrote that the data provided in the July 15, 2010, notice regarding the seller concession cap failed to demonstrate a significant risk to the FHA portfolio to justify the change. Further, commenters questioned the accuracy of the statistical data illustrating the correlation between higher seller concessions and an increased rate of default.

HUD Response. HUD has amended its proposal in response to these comments. The Department conducted a more complex analysis of portfolio performance involving seller concessions, which revealed that the risk to the MMIF increased for loans with larger closing costs and concessions. Table E demonstrates that for loan amounts in excess of $240,000 for FY 2009, credit risk rises faster and higher than it does for lower loan amounts when closing costs and concessions exceed 3 percent. Table F shows that the highest risk exists with loans greater than $360,000 and concessions are above 4 percent.

Comment: Proposed cap does not address true problems in the housing market. Several commenters wrote that the proposed cap will be ineffective because it fails to address the true causes of increased defaults. Some of these commenters wrote that unscrupulous lending practices were primarily responsible for the increased mortgage defaults, while other commenters pointed at artificially inflated appraisals and sales prices.

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HUD Response. HUD has amended its proposal in response to these comments. The Department agrees that reducing seller concessions alone will not address the true problems associated with increased defaults and the volatility in the housing market. However, this revised proposal, in conjunction with other efforts to strengthen enforcement actions and reduce risk, will help ensure that borrowers relying on FHA-insured financing have sufficient investment in their home purchases and are therefore less likely to default. This revised proposal will also help curtail a practice where seller concessions are offered an amount above the borrower's actual costs as an offset to a higher sales price.

Comment: Proposed cap will harm the housing market. Several commenters wrote that the proposed cap could have a chilling effect on the origination of new mortgages. Commenters wrote that reducing seller concessions from 6 percent to 3 percent would reduce the qualified borrower pool and remove a large portion of borrowers who would otherwise be approved under stringent underwriting requirements. The commenters wrote that many FHA buyers require the seller's contribution in order to proceed with the purchase of the home. Additionally the reduction in sellers concessions, some commenters argued, could result in less money available for post-purchase incidentals including home improvements and emergencies.

HUD Response. HUD amended its proposal in response to these comments. HUD recognizes that borrowers with lower loan amounts were more negatively impacted by the initial proposal from the July 15, 2010, notice than borrowers with high loan amounts. However, as evidenced in Tables A, B, C, and D, the impact of any change to seller concessions would not be as great as indicated by the commenters. As shown in Table C, the largest single concentration of loans (13.77 percent) is where both closing costs and concessions are between 2 and 3 percent of home value. In Table A, closing costs occur in this range for more than 30 percent of all

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home purchase loans insured by FHA. Table B shows that concessions in this range represents 37 percent of loans with concessions. The next largest concentration is for loans where closing costs and concessions are between 1 and 2 percent of property value (7.62 percent). Table A highlights how fixed cost factors tend to create percentage amounts that are greatest for small balance loans. Over 70 percent of loans of up to $180,000 have closing costs in excess of 3 percent of property value. This difference is attributed to the fact that many closing costs are fixed (e.g., appraisals, title services, inspections, and flood and lien certifications), and not a percentage of loan amount (e.g., origination charge, title insurance). Therefore, the revised proposal allows for greater than 6 percent seller concessions on loans with a sales price of less than $100,000 and allows for seller concessions greater than 3 percent for loans with a sales price up to $200,000. It is anticipated that this revised proposal will minimize, if not eliminate, the concerns that a reduction in seller concessions would have a negative impact on the housing market. Also, this proposal will assist borrowers who are less able to absorb the post-purchase financial costs of home improvements and emergency repairs, by not requiring them to devote all available funds to the acquisition of the home.

Comment: Reduction in seller's cap will disproportionately impact low-income and first-time homebuyers. Several commenters suggested that the proposed seller concession cap will unfairly impact low-income and first-time homebuyers. The reduction from 6 percent to 3 percent will impact less expensive properties and have a disparate impact on lower income borrowers and potential homeowners purchasing homes worth less than $150,000. The cap will burden low income buyers and require a higher percentage of cash relative to buyers purchasing more expensive homes. Additionally, commenters wrote that first-time homebuyers are less likely to have cash available to meet closing costs. The commenters wrote that these buyers rely

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heavily on the 6 percent seller's concessions and will experience a greater decrease in buying power than second- or third- time buyers.

HUD Response. HUD has amended its proposal in response to these comments and agrees that an across-the-board reduction in seller concessions had a disproportionately negative impact on low- and moderate-income borrowers purchasing lower priced homes. As noted in previous responses, this revised proposal allows for greater than 6 percent seller concessions on loans with sales prices less than $100,000 and allows for seller concessions greater than 3 percent for loans with sales prices up to $200,000 (See Table I).

Comment: Proposed cap fails to consider regional differences in housing markets. Several commenters wrote that the reduction in seller concessions to 3 percent should be reevaluated to account for varying home prices regionally. Commenters wrote that closing costs, taxes, and insurance vary greatly by state. The commenters wrote that the 3 percent cap will have a variable impact on buyers depending on the regional market and that HUD should consider a more flexible market-driven approach.

HUD Response. HUD does not engage in regional eligibility and underwriting standards based on local market conditions. FHA's role in stabilizing the current housing market is due to the fact that its programs are available under the same terms and conditions regardless of the borrower's and subject property's location. However, HUD does recognize that there are regional differences in the housing market and, therefore, it crafts its policies by taking these differences into consideration. HUD analyzed FHA loans from both high-cost and low-cost states and used a reasonable range (25^{th} percentile to 75^{th} percentile) to determine the appropriate cutpoints. HUD also reviewed various external closing cost studies such as by Bankrate.com

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and analyzed additional external data provided by an FHA-approved lender. HUD is confident that its own analysis is consistent with other reliable closing costs studies.

C. Alternative Approaches

Comment: HUD should defer instituting a cap. Several commenters wrote that the analysis provided in the July 15, 2010, notice was conducted prior to the implementation of other recently enacted FHA risk management initiatives and, therefore, does not take the beneficial impact of such changes into account. The commenters questioned whether the increase in average default rates was caused by the difference in seller concessions or by some other factor such as lower borrower credit scores. The commenters proposed that HUD delay implementing the 3 percent cap until the results and impacts of the other recently implemented FHA risk change can be tracked. Commenters suggested that HUD analyze the performance of loans left at a 6 percent cap for 2 years prior to instituting the change.

HUD Response. HUD has amended its proposal in response to these comments. HUD believes that it has completed the necessary due diligence in proposing a reduction in seller concessions, from analyzing the impact on its portfolio to the impact a reduction would have on the housing market. As part of the analysis for this revised proposal, which includes performance data from FYs 2009 and 2010, HUD did not include loans it no longer insures, such as those with credit scores below 580 and LTVs greater than 90 percent, as well as those with seller-funded downpayment assistance. By eliminating these loans from the analysis, HUD was able to analyze seller concessions and their impact on the portfolio without skewing the data with known factors that more likely contributed to the default and claim. Readers are referred to the discussion in Section II that illustrates the need to make these reductions while at the same time

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preserving the 6 percent cap for those borrowers who need it the most; i.e., low- and moderate-income borrowers purchasing lower priced homes.

Comment: HUD should allow for gradual reduction of seller concessions. Commenters recommended that if HUD plans to implement the reduction in seller concessions, that a gradual approach be used. Commenters argued that the 3 percent reduction would result in many buyers being priced out of the market. Commenters argued that a gradual approach would protect potential buyers and would allow HUD to study the impact of each change.

HUD Response. HUD believes that its revised proposal has essentially the same effect the commenters are seeking, ensuring that a reduction to seller concessions has minimal impact on the housing market and that borrowers who need additional assistance in purchasing a home may receive it. As stated previously, this revised proposal allows for seller concessions greater than 6 percent on loans with sales prices less than $100,000 and permits seller concessions greater than 3 percent for loans with sales prices up to $200,000 (See Table I).

Comment: Cap seller concessions by dollar amount in addition to percentage. Several commenters wrote that providing a dollar range in addition to a percentage would resolve regional and economic disparity issues posed by the proposed 3 percent cap.

HUD Response. HUD has amended its proposal based on these comments and has proposed that seller concessions be reduced to 3 percent or $6,000, whichever is the greater (but not to exceed the borrower's actual costs). Like the commenters, the Department believes that combining a cap based on percentage with a cap based on a dollar amount addresses the regional and economic disparities that may have occurred with an across-the-board reduction. Readers are directed to the discussion in Section II regarding this revised proposal.

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Comment: Base seller concessions on buyer credit score. Several commenters suggested that FHA adopt a graduated system for determining the allowable amount of seller concessions. Commenters suggested basing this graduated system either on income level or credit score. Commenters suggested that a graduated approach will more directly speak to the correlation between poor credit and default. Rather than reduce the seller contribution of FHA transactions to 3 percent universally, commenters suggested that FHA adjust the cap using other risk identifiers such as correlating the seller concession with credit scores.

HUD Response. HUD believes that limiting seller concessions based on the borrower's income level and credit score would not achieve its mission of assisting low-income borrowers overcome a chief obstacle to purchasing a home: having sufficient funds for a downpayment, as well as for paying all of their closing costs. With this revised proposal, HUD is striking the appropriate balance between its historic role of making it easier for families to purchase their homes, while at the same time ensuring that they have sufficient investment in their home purchases and are therefore less likely to default.

Comment: HUD should align the seller concession cap with other federal programs. Several commenters suggested that if HUD implements a reduction in the allowable amount of seller concessions, that it should be reduced to 4 percent. This reduction would align it with the Department of Veterans Affairs Veterans' Home Loan Program.

HUD Response. HUD did consider aligning itself with the Department of Veterans Affairs Veterans' Home Loan Program but found in its analysis that doing so would have resulted in a disproportionately negative impact on borrowers purchasing lower priced homes. By combining a percent cap with a dollar amount cap, HUD believes that it has addressed such disparities and minimizes the impact a reduction in seller concessions may have on the market.

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IV. Findings and Certification

Executive Order 12866, Regulatory Planning and Review

The Office of Management and Budget (OMB) reviewed this notice under Executive Order 12866 (entitled "Regulatory Planning and Review"). The notice was determined to be a "significant regulatory action," as defined in section 3(f) of the Order (although not economically significant, as provided in section 3(f)(1) of the Order).

As discussed in this preamble, this notice proposes to reduce the amount of closing costs a seller may pay on behalf of a homebuyer purchasing a home with financing insured by FHA. The increased role of FHA in the mortgage lending marketplace, combined with the economic difficulties faced by many FHA borrowers, has increased the risk to the FHA insurance funds. While HUD has undertaken several steps to mitigate this risk and strengthen the financial soundness of the FHA programs, a reduced cap on seller concessions remains a vitally needed reform.

As provided in the economic analysis that accompanies this notice, the combined compliance cost for borrowers and sellers under HUD's proposal to reduce seller concessions ranges from $21 million to $97 million. The actual cost of compliance depends greatly on the state of the housing mortgage market. Where the mortgage market is healthier and private lending is available, the cost of compliance will be at the lower end of the range, and concomitantly at the higher end of the range in a slowed market in which private lending is substantially reduced. With respect to benefits, HUD expects its proposal to help prevent foreclosures in the amount of approximately $25 million, and prevention of foreclosures means sustainable homeownership. Another highly important benefit will be to reduce the net losses to the FHA insurance fund resulting from high rates of insurance claims. The total gain to FHA

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from the implementation of HUD's proposal as presented in this notice is expected to range from $60 million to $70 million. As the current housing market has shown, the importance of maintaining FHA as a source of credit for homeownership is a highly important benefit, which cannot be overstated.

Because of the downturn in the housing market, FHA loans are now in higher demand as a result of the absence of sufficient private lending in the mortgage market. The volume of FHA insurance increased rapidly as private sources of mortgage finance retreated from the market. As noted earlier in this preamble, FHA's share of the single-family mortgage market today is approximately 33 percent – up from 3 percent in 2007, and the dollar volume of insurance written has jumped from the $77 billion issued in that year to $319 billion in 2010. Accordingly, over the last several years, FHA's primary contribution to the public is to provide a financing source for affordable and sustained homeownership when the market is not achieving this goal on its own. FHA cannot, however, contribute to sustained homeownership if FHA itself is not sustained.

As has been reported, FHA's capital reserve ratio has fallen below the statutorily mandated minimum capital reserve ratio of 2 percent. A primary reason why is that the recent demands placed on FHA have resulted in increased losses to the FHA insurance fund. FHA has a fiduciary duty, imposed by statute, to preserve the MMIF and to maintain the capital ratio of the MMIF at not less than 2 percent. In brief, FHA must take action to reduce risks and eliminate losses. FHA has already taken several steps to reduce risks, and this proposal on reduced seller concessions is another such measure to do so and restore the MMIF to the statutory minimum capital reserve ratio.

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The full economic analysis is available for review at www.regulations.gov. The docket file is available for public inspection in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410-0500. Due to security measures at the HUD Headquarters building, please schedule an appointment to review the docket file by calling the Regulations Division at 202-402-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Relay Service at 800-877-8339.

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 et seq.) generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. The notice reduces the seller concessions cap. The benefit of this action will be to reduce the net losses due to mortgage defaults. As noted in the economic analysis for the notice, few borrowers are served in the categories that would be excluded under the new policies, relative to the total FHA portfolio. Further, as noted by many of the public commenters on the July 15, 2010, notice, the policy changes being made by FHA aligns the seller concession cap with that found in the conventional mortgage market. The impact of the policy changes will, therefore, largely be limited to conforming FHA standards to widespread industry practice.

Environmental Impact

A Finding of No Significant Impact (FONSI) with respect to the environment was prepared for the July 15, 2010, notice, in accordance with HUD regulations at 24 CFR part 50, which implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42

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U.S.C. 4332(2)(C)). The Finding of No Significant Impact remains applicable to this notice and is available for public inspection between the hours of 8 a.m. and 5 p.m. weekdays in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410. Due to security measures at the HUD Headquarters building, please schedule an appointment to review the FONSI by calling the Regulations Division at 202-708-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Information Relay Service at 800-877-8339.

Executive Order 13132, Federalism

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any document that has federalism implications if the document either imposes substantial direct compliance costs on state and local governments and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This document would not have federalism implications and would not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531-1538) (UMRA) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments, and on the private sector. This document would not impose any federal mandates on any state, local, or tribal governments, or on the private sector, within the meaning of the UMRA.

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Date: January 30, 2012

Carol J. Galante
Acting Assistant Secretary for Housing—
Federal Housing Commissioner

[FR-5572-N-01]

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